Cement: Cost Pressure to Stay Even as Demand Grows in FY23

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CareEdge RESEARCH

Growth in India's cement sector has seen a strong bounce back in FY22. The year closed with a growth of 20%, reaching an all-time high, after witnessing a decline of 11% in FY21. The jump was on account of the government's infrastructure push via various schemes and allocations towards the creation of hard assets and a low base effect.

Growth Trend Continues in Production

FY21 created a low base primarily because of the Covid-19 pandemic. This, coupled with pent-up demand, has led to the reversal in the muted trend in volumes. The 20% production growth in FY22 was driven by the strong recovery witnessed during H1 FY22, which saw a y-o-y growth of 36%.

While Q1 FY22 recorded a strong double-digit growth of 54%, sustaining the momentum in Q2 FY22 with 22% growth, it remained slightly subdued in Q3 FY22 as demand was negatively impacted due to sudden rains, a ban on construction activities in the National Capital Region, shortage of labour and restricted supply of sand in the Eastern region.

Table 1: Quarterly Cement Production in (Million tonnes)

Particulars	Q1	Q2	Q3	Q4	Total	Growth %
FY19	85	77	83	91	337	13%
FY20	86	78	84	87	334	-1%
FY21	53	69	81	93	296	-11%
FY22	82	85	87	102	356	20%

Source: CMIE, Office of Economic Adviser

However, the demand picked up from December 2022 onwards with a 13% y-o-y growth and remained strong in Q4 FY22 as the quarter reported a sequential growth of 17%, surpassing the 100MT mark.

Due to the elections held in five states, disruption in construction activity dragged the demand growth to 5% in February 2022, which saw a reversal in trend with a strong uptick in March 2022. While looking at the region-wise demand situation, the following trends have been observed:

- Central and South regions have seen the rise in demand on account of pick up in rural housing along with infrastructure activity seems uplifting. Government and commercial projects also supported institutional demand.

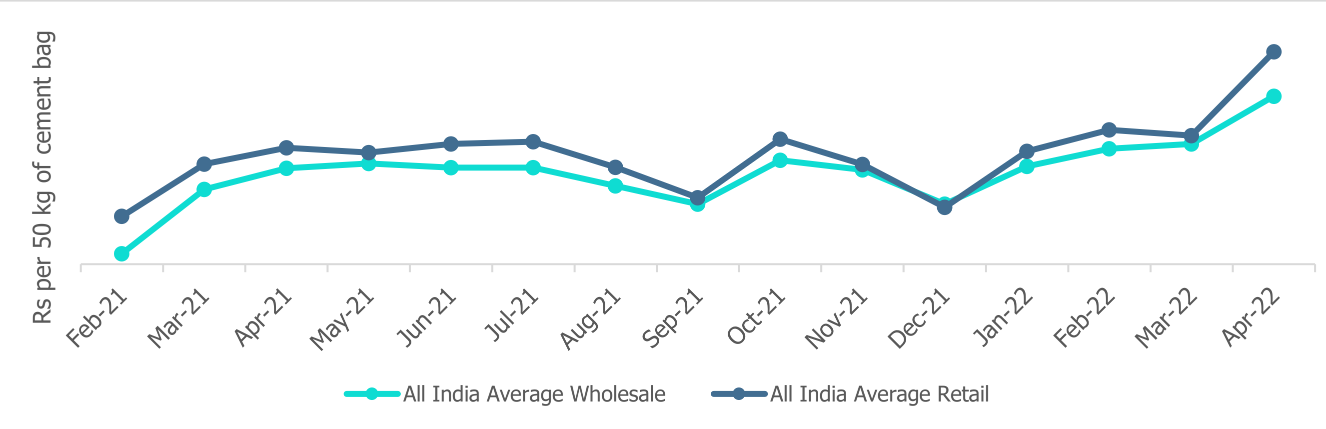
- On the other hand, East and West regions witnessed low-to-marginal growth in housing and infrastructure due to degrowth in urban housing and infrastructure.

- Flat volume trend has been noticed in the North region due to a moderation in urban housing. However, rural housing and infrastructure supported demand.

Cement Price Trend

All-India retail cement prices remained elevated throughout FY22 barring December when they bottomed out at Rs 349 per bag. Post that, the sector had witnessed a sharp uptick of ~23% in Q4 FY22. This was primarily on account of rising input and fuel cost pressure due to geopolitical tensions. It is expected that the prices will remain uplifted in the short term as manufacturers will continue to pass on the rising costs.

Chart 1: Cement Price Trend (Rs Per 50 Kg of Cement Bag)

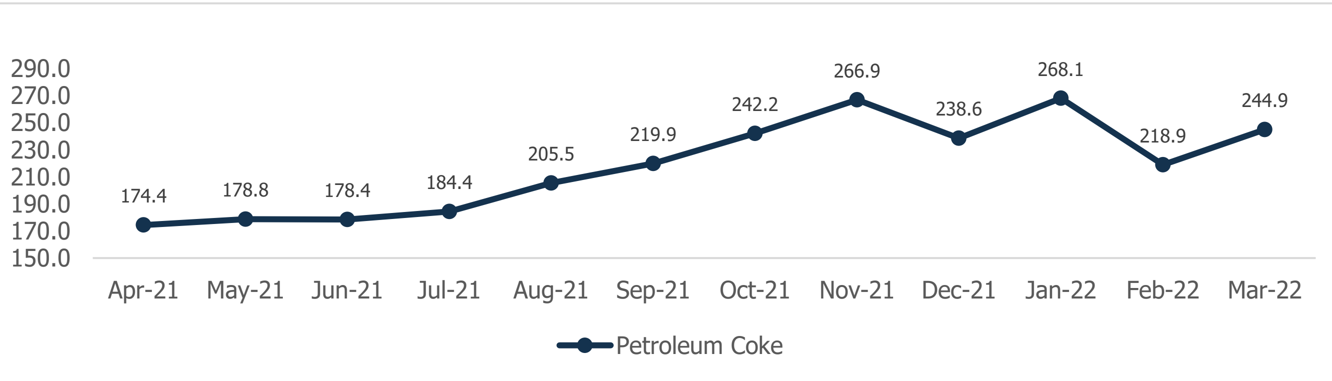


Source: CMIE

Geopolitical Tension to Fuel Input Cost Pressure

The price hikes can be attributed to the increase in input costs as power, fuel and freight expenses rose. Together, these account for 50–55 per cent of the total expenditure incurred by the cement companies. Crude oil prices went up at a whopping rate of 74% in FY22. Tracking this, Petcoke has also reported a sharp increase of ~71 per cent y-o-y as per the WPI index.

Chart 2: Petcoke Price WPI Index



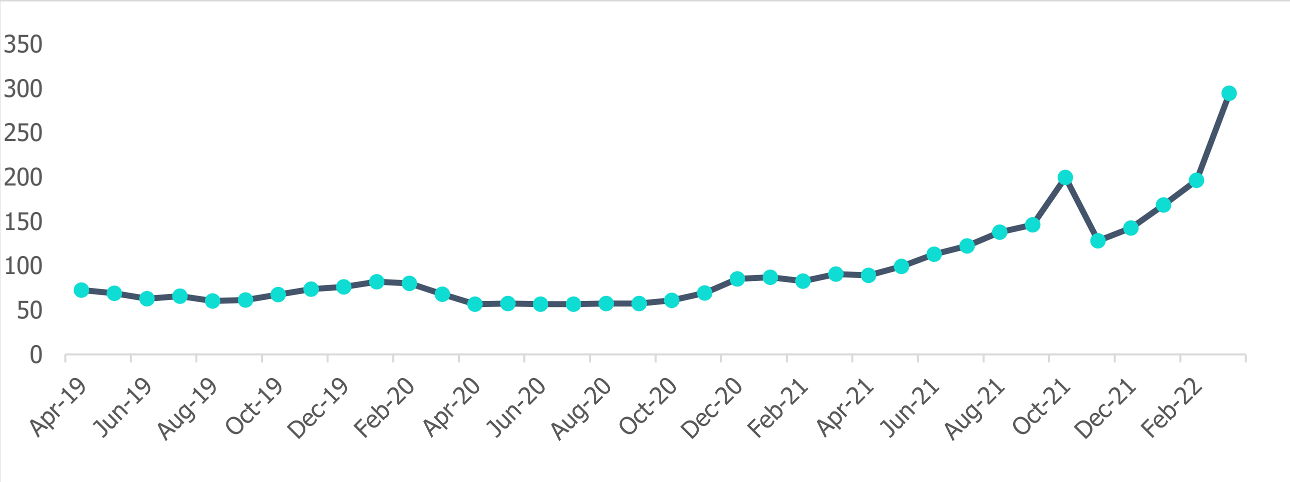
Source: Office of Economic Adviser

International coal prices soared to USD 294.42/MT (record high), sequentially higher by 50 per cent on account of the following reasons.

- Potential disruption in Russia's coal exports amid its ongoing conflict with Ukraine has impacted prices to a major extent.
- Diminishing inventory levels, owing to the widening of the demand-supply gap (primarily caused by rebounding demand and pandemic related supply constraints globally), have aggravated pricing pressure.

- Indonesia's temporary ban on coal exports has intensified the current tightness in the market, thereby increasing the pricing pressure.

Chart 3: International Coal Prices (USD/MT)

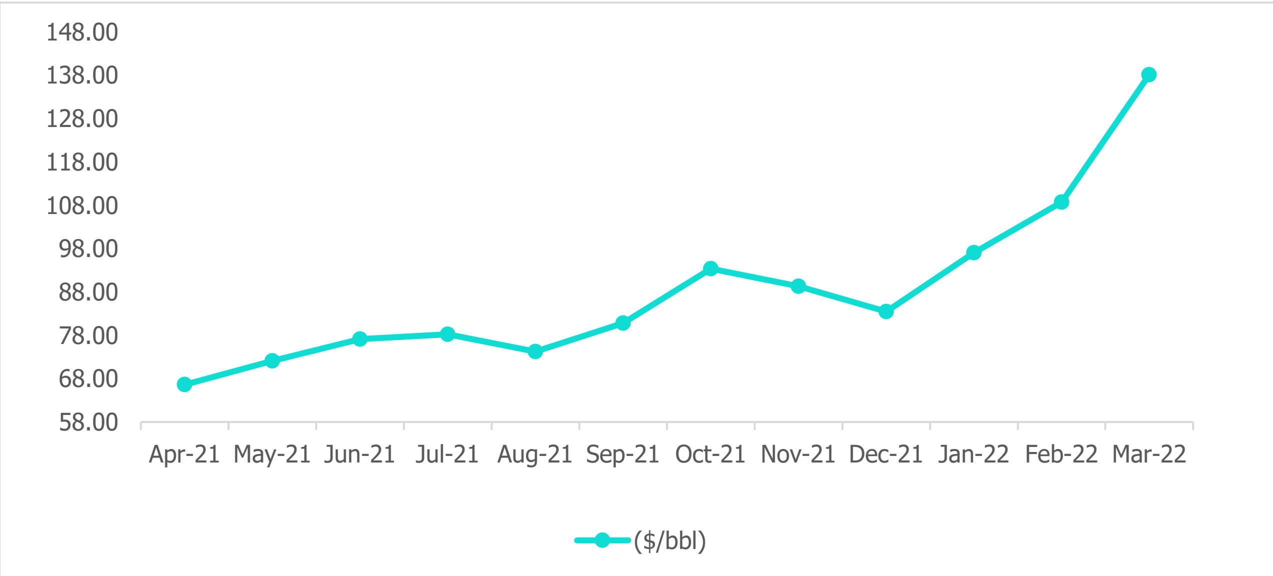


Source: World Bank Data

The surge in crude oil prices has raised freight costs significantly, resulting in diesel prices doubling up from the price point at the beginning of the year.

Elevated input costs, coupled with high freight and fuel expense, have aggravated the cost pressure, which in turn has impacted the profitability of cement companies.

Chart 4: Rising Diesel Prices ($/bbl)



Source: Petroleum Planning and analysis cell

*Prices are for 10PPM Arab Gulf Gasoil

Outlook

Owing to strong momentum in housing, infrastructure, and industrial development, the cement industry in India is set to see an upswing in demand in FY23. CareEdge Research believes the industry is likely to move at high single-digit growth on account of government thrust for infrastructure and strong traction in capital expenditure. Various initiatives by the government along with several MSME schemes are set to propel capital expenditure from private players.

Factors likely to aid demand:

- **Urban and Rural Housing:**
  - Demand revival expected in real estate
  - Positive momentum is likely in rural demand due to the promising rabi crop outlook
  - The construction of nearly 8 million houses is likely to generate demand from the rural segment

- **Infrastructure:**
  - 25,000 kilometres of roads are targeted in FY23
  - Positive momentum is expected in urban infrastructure, Bharatmala and Metro projects
  - Positive infra outlay in state Budgets

- **Industrial and Commercial:**
  - Implementation of PLI scheme to boost the demand further
  - Aggressive targets, coupled with the PLI scheme and the rising capital expenditure
  - The increasing emergence of e-commerce and retail would likely push demand for warehouse
  - The government’s aim of 220 airports by 2025 would further boost the demand

While demand is likely to remain strong in FY23, headwinds arising out of rising cost pressure could create some stress on the profitability of cement companies. Resultant price hikes by cement producers will become evident and might sustain in the near term. However, due to the competitive nature of the industry, the magnitude of the price hikes driven by cost pressure remains to be seen.

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